

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

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Refer Reply To:
CC:TEGE:EOEG:EO2
PLR-115901-15

Date:
November 3, 2015

Organization =
State =
Year A =
Year B =
Original Bonds =
Bond 1 =
Bond 2 =
Project =
Component =
x% =
y% =
z% =
Date 1 =
Date 2 =
Bond X =
Bond Y =
Bank =

Dear :

This letter responds to a letter from Organization's authorized representative dated April 24, 2015, requesting a ruling that the Organization's payment of the Component of Bond Y will not adversely affect the status of the income of the Organization as not included in gross income pursuant to IRC section 115. Organization represents the facts as follows.

Organization is a State nonprofit corporation. Organization has represented that all of its income is excludable under IRC section 115(1) in that its income is derived from an

essential governmental function and all of its income accrues to the State or a political subdivision of State.

In Year A, State issued tax-exempt Original Bonds consisting of Bond 1 and Bond 2 and loaned the proceeds to Organization to fund the Project. Under the financing agreement, Organization made payments of debt service to State equal to the debt service due on Original Bonds. The payments from Organization to State were used to make debt service payments to the holders of Original Bonds. In Year B, Organization defaulted on making its debt service payments under the financing agreement and filed for bankruptcy.

Pursuant to the plan of reorganization approved by the Bankruptcy Court, Organization issued Bond X and Bond Y in satisfaction of certain claims against Organization, arising primarily out of the default on Original Bonds. Bond X and Bond Y were issued to the holders of Bond 1 on a pro rata basis and Original Bonds were discharged.

Bond Y bears interest at the rate of x% through Date 1 and y% thereafter, plus a Component payment. The Component is equal to z% of net Project revenue that is available after the payment of the fixed rate of interest on the Bond X and Bond Y. In no event will the Component payments exceed the Deficiency Amount. The Deficiency Amount is defined as the difference between the aggregate scheduled debt service on Bond 1 accrued through the date Organization filed its voluntary petition for bankruptcy, less the sum of the payment offered or paid by Bank in its offer for Bond 1 and all principal and interest previously paid on Bond X and Bond Y. The Component payment is intended to allow Bond 1 holders of Original Bonds to recover, without any duplication, principal and interest accrued or the accreted value of capital appreciation.

Law and Analysis

IRC section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, operated, and funded by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC section 115(1) because the organization is performing an essential governmental function and the income accrues to the political subdivisions. In reaching these conclusions, the revenue ruling explains that, other than an incidental benefit to employees by insuring against the risks, private interests do not participate in or benefit from the operation of the organization and private interests do not benefit from the income of the organization.

Organization used Original Bonds to fund Project. Pursuant to the Bankruptcy Court Order, Original Bonds were discharged and replaced with Bond X and Bond Y. Component allows bondholders of Bond Y the potential to recover principal and interest or the accreted value of capital appreciation amounts of Bond 1 that was discharged by the Bankruptcy Court. The benefit to the bondholders of Bond Y receiving the Component payment is no greater than what they would have received as the bondholders of Bond 1 had the Organization not reorganized under the bankruptcy laws. Furthermore, based on the facts above, terms of the Component are a means to ensure that the holders of the Bond Y recover the amounts originally owed under the Bond 1. The Project revenues are simply the source from which the amounts originally owed under the Bond 1 will be paid.

Based solely on the facts and representations submitted by Organization, we conclude that the payment of Component to the holders of Bond Y in an amount no more than originally owed to the holders of Bond 1 does not benefit private interests more than incidentally for purposes of determining whether the income of Organization otherwise satisfies the requirements for the exclusion under IRC section 115(1).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether Organization's income is derived from the exercise of an essential governmental function or whether Organization otherwise satisfies the accrual requirement of IRC section 115(1), such that its income is excludable from gross income under IRC section 115(1).

In addition, no opinion is expressed on whether the Original Bonds are debt obligations for federal income tax purposes.

This ruling is directed only to the taxpayer requesting it. IRC section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/S/

Andrew F. Megosh, Jr.
Senior Tax Law Specialist
Exempt Organizations
(Tax Exempt & Government Entities)

cc: